

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name Alpena General Hospital	County Alpena
Audit Date 6/30/05	Opinion Date 9/8/05	Date Accountant Report Submitted to State: 10/27/05	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

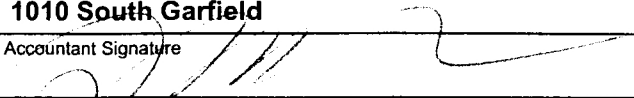
1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- | | |
|---|---|
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

We have enclosed the following:	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).			✓

Certified Public Accountant (Firm Name) Plante & Moran, PLLC			
Street Address 1010 South Garfield	City Traverse City	State MI	ZIP 49686
Accountant Signature 		Date 10/27/05	

Alpena General Hospital

Financial Report

June 30, 2005

Alpena General Hospital

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Plante & Moran, PLLC
1010 S. Garfield Ave.
Traverse City, MI 49686
Tel: 231.947.7800
Fax: 231.947.0348
plantemoran.com

Independent Auditor's Report

To the Board of Trustees
Alpena General Hospital

We have audited the accompanying statement of net assets of Alpena General Hospital (a component of Alpena County) as of June 30, 2005 and 2004 and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Alpena General Hospital at June 30, 2005 and 2004 and the results of its operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements do not present a management's discussion and analysis, which would be an analysis of the financial performance for the year. The Governmental Accounting Standards Board has determined that this analysis is necessary to supplement, although not required to be a part of, the basic financial statements.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 8, 2005 on our consideration of Alpena General Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements. The purpose of that report is to describe the scope of our testing on internal controls over financial reporting and compliance and the results of that testing, and not to provide opinions on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Plante & Moran, PLLC

September 8, 2005



A worldwide association of independent accounting firms

Alpena General Hospital

Statement of Net Assets

	June 30, 2005	June 30, 2004
Assets		
Current Assets		
Cash and cash equivalents (Note 2)	\$ 2,316,285	\$ 1,827,097
Accounts receivable (Note 3)	5,727,004	3,477,967
Estimated third-party payor settlements	1,752,369	1,536,775
Current portion of assets limited as to use (Note 5)	818,741	783,693
Prepaid expenses and other	1,869,527	1,746,258
Inventory	2,540,288	2,249,050
Total current assets	15,024,214	11,620,840
Assets Limited as to Use (Note 5)	12,301,704	11,677,607
Property and Equipment (Note 6)	35,500,096	37,460,183
Other Assets		
Investment in joint venture	1,676,812	1,910,964
Bond issue costs	302,227	338,954
Total assets	\$ 64,805,053	\$ 63,008,548
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt (Note 7)	\$ 1,664,155	\$ 1,424,222
Accounts payable	2,137,513	1,855,518
Estimated third-party payor settlements	398,541	571,121
Accrued liabilities and other:		
Accrued compensation	2,643,930	2,085,302
Accrued compensated absences	2,482,907	2,237,649
Accrued professional and other liability claims (Note 10)	677,000	677,000
Accrued interest	114,985	126,553
Other accrued liabilities	868,866	747,680
Total current liabilities	10,987,897	9,725,045
Long-term Debt (Note 7)	13,581,082	14,623,813
Deferred Revenue (Note 9)	1,606,182	1,668,582
Total liabilities	26,175,161	26,017,440
Net Assets		
Invested in capital assets - Net of related debt	20,060,825	20,971,610
Restricted:		
Donor restricted for specific purpose	414,730	447,972
Donor restricted for development	1,287,915	1,319,031
Unrestricted	16,866,422	14,252,495
Total net assets	38,629,892	36,991,108
Total liabilities and net assets	\$ 64,805,053	\$ 63,008,548

Alpena General Hospital

Statement of Revenues, Expenses, and Changes in Net Assets

	Year Ended	
	June 30, 2005	June 30, 2004
Operating Revenues		
Net patient service revenue (Note 4)	\$ 84,723,964	\$ 74,635,031
Other	2,934,846	2,996,748
Total operating revenues	87,658,810	77,631,779
Operating Expenses		
Salaries and wages	37,487,519	34,405,592
Employee benefits and payroll taxes	13,182,911	12,254,716
Medical supplies and drugs	15,483,312	13,908,680
Professional services and recruiting	5,650,907	5,341,276
Utilities and food	1,493,716	1,436,699
Other	8,789,092	6,493,545
Depreciation	4,767,776	4,479,857
Total operating expenses	86,855,233	78,320,365
Operating Income (Loss)	803,577	(688,586)
Nonoperating Revenue (Expenses)		
Investment income	190,664	105,852
Loss on sale of capital assets	(39,406)	(79,266)
Noncapital grants and contributions	658,020	198,662
Property tax revenue	800,537	760,815
Interest on capital assets - Related debt	(774,608)	(767,793)
Net nonoperating revenue	835,207	218,270
Excess of Revenue Over (Under) Expenses Before Capital Grants	1,638,784	(470,316)
Capital Grants	-	523,590
Increase in Net Assets	1,638,784	53,274
Net Assets - Beginning of year	36,991,108	36,937,834
Net Assets - End of year	\$ 38,629,892	\$ 36,991,108

Alpena General Hospital

Statement of Cash Flows

	Year Ended	
	June 30, 2005	June 30, 2004
Cash Flows from Operating Activities		
Cash received from patients and third-party payors	\$ 82,086,753	\$ 75,011,393
Cash payments to employees and suppliers	(80,691,072)	(73,725,108)
Other receipts from operations	2,872,446	2,934,348
Net cash provided by operating activities	4,268,127	4,220,633
Cash Flows from Investing Activities - Investment income	87,927	15,852
Cash Flows from Capital and Related Financing Activities		
Proceeds from sale of capital assets	21,449	61,803
Issuance of long-term debt	728,383	1,128,035
Property tax levy	800,537	760,815
Purchase of investments	(4,288,529)	(3,111,254)
Proceeds from sales and maturities of investments	2,493,046	14,798,861
Contributions restricted for capital expenditure	658,020	722,252
Interest paid on long-term debt	(737,881)	(729,573)
Principal payments on long-term debt	(1,531,181)	(1,205,000)
Purchase of capital assets	(3,147,048)	(7,383,954)
Net cash (used in) provided by capital and related financing activities	(5,003,204)	5,041,985
Net (Decrease) Increase in Cash and Cash Equivalents	(647,150)	9,278,470
Cash and Cash Equivalents - Beginning of year	12,348,859	3,070,389
Cash and Cash Equivalents - End of year	\$ 11,701,709	\$ 12,348,859
Balance Sheet Classification of Cash and Cash Equivalents		
Cash and cash equivalents	\$ 2,316,285	\$ 1,827,097
Assets limited as to use	9,385,424	10,521,762
Total cash and cash equivalents	\$ 11,701,709	\$ 12,348,859

Alpena General Hospital

Statement of Cash Flows (Continued)

A reconciliation of operating income (loss) to net cash from operating activities is as follows:

	Year Ended	
	June 30, 2005	June 30, 2004
Cash Flows from Operating Activities		
Operating income (loss)	\$ 803,577	\$ (688,586)
Adjustments to reconcile operating income (loss) to net cash from operating activities:		
Depreciation	4,767,776	4,479,857
Provision for bad debts	2,441,000	2,044,000
(Increase) decrease in assets:		
Patient accounts receivable	(4,690,037)	(1,609,630)
Third-party settlement receivables	(215,594)	(629,129)
Inventories	(291,238)	(62,188)
Prepaid expenses and other current assets	213,620	1,304,570
Increase (decrease) in liabilities:		
Accounts payable	560,499	(1,103,592)
Accrued liabilities	913,504	(23,390)
Third-party settlement payable	(172,580)	571,121
Deferred revenue	(62,400)	(62,400)
Net cash provided by operating activities	<u>\$ 4,268,127</u>	<u>\$ 4,220,633</u>

At June 30, 2005 and 2004, the Hospital had \$194,034 and \$472,538, respectively, recorded in accounts payable that related to construction in progress costs and equipment purchases.

Alpena General Hospital

Notes to Financial Statements June 30, 2005 and 2004

Note 1 - Nature of Business and Significant Accounting Policies

Reporting Entity - Alpena General Hospital (the "Hospital") is a short-term, acute-care facility offering inpatient and outpatient health care services primarily to citizens in Alpena County, Michigan and surrounding areas. The Hospital is organized under Public Act 230 of the Public Acts of 1987 as a county health facilities corporation.

The board of county commissioners appoints the board of trustee members of the Hospital, and the Hospital may not issue debt or levy taxes without the county's approval. For this reason, the Hospital is considered to be a component unit of Alpena County and is included as a discretely presented component unit in the basic financial statements of the County.

The accounting policies of the Hospital conform to accounting principles generally accepted in the United States of America as applicable to local governmental units. Because the Hospital provides a service to citizens that is financed primarily by a user charge, the accounts of the Hospital are accounted for as an enterprise fund, utilizing the full accrual method of accounting.

Basis of Presentation - The financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, issued in June 1999. The Hospital follows the "business-type" activities reporting requirements of GASB Statement No. 34, which provide a comprehensive look at the Hospital's financial activities. No component units are required to be reported in the Hospital's financial statements. As permitted by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Hospital has elected to not apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), issued after November 30, 1989.

Cash and Cash Equivalents - Cash and cash equivalents include investments in highly liquid debt instruments with a maturity of three months or less, excluding amounts limited as to use by board designation or other arrangements under trust agreements and donor restricted cash.

Inventory - Inventory is stated at the lower of cost (first-in, first-out method) or market.

Property and Equipment - Property and equipment amounts are recorded at cost or fair market value at date of donation. Depreciation is computed principally on the straight-line basis over the estimated useful lives of the assets. Costs of maintenance and repairs are charged to expense when incurred.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Deferred Debt Issue Costs - Financing costs are amortized over the life of the related bond issue using the interest method.

Investments - Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the balance sheet. Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in the excess of revenue over (under) expenses unless the income or loss is restricted by donor or law.

Investment in Joint Ventures - Investments in joint ventures are comprised mainly of investments the Hospital has in companies in which the Hospital has 20 percent to 50 percent ownership interests. These investments are carried at cost, adjusted for the Hospital's proportionate share of its undistributed earnings and losses.

Paid Time Off - The Hospital maintains a paid time off policy. The benefits are charged to operations when earned. Earned benefits are recorded as current liability in the financial statements.

Capital-related Net Assets - Capital-related net assets are net assets related to the purchase of property and equipment, net of related debt and payables.

Donor-restricted Net Assets - Donor-restricted net assets are net assets temporarily restricted for donor-specified purposes or the development fund relating to the purchase of capital assets. Donor-restricted net assets are released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors.

Operating Revenue and Expenses - The Hospital's statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenue and expenses. Operating revenue results from exchange transactions associated with providing health care services, which is the Hospital's principal activity. Nonexchange revenue, including taxes, grants, and contributions received for purposes other than capital asset acquisition, is reported as nonoperating revenue. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Charity Care - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care amounts to less than 1 percent of patients served.

Alpena General Hospital

Notes to Financial Statements June 30, 2005 and 2004

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Tax Levy - On December 1, 2002, the citizens of Alpena County approved a tax levy not to exceed one mill on the taxable value of property in Alpena County for a period of five years. The purpose of this levy is to be used for the acquisition, construction, and equipping of health care facilities by the Hospital.

Contributions, Bequests, and Grants - Unrestricted gifts and bequests are included in other operating revenue when received.

Reclassification - Certain 2004 amounts have been reclassified to conform to the 2005 presentation.

Note 2 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The Hospital has designated four banks for the deposit of its funds. The Hospital's deposits and investment policies are in accordance with statutory authority, which is the same as the Hospital's policy.

The Hospital's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the Hospital's deposits may not be returned to it. The Hospital does not have a specific deposit policy for custodial credit risk. At June 30, 2005, the Hospital had \$7,416,636 of bank deposits (certificates of deposit and checking and savings accounts) that were uninsured and uncollateralized. The Hospital believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the Hospital evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Alpena General Hospital

Notes to Financial Statements June 30, 2005 and 2004

Note 2 - Deposits and Investments (Continued)

Interest Rate Risk - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Hospital's investment policy does not restrict investment maturities, other than commercial paper, which can only be purchased with a 270-day maturity. At year end, the average maturities of investments are as follows:

Investment	Fair Value	Maturity
Sweep account	\$ 536,000	7/1/05
Commercial paper	2,500,000	7/25/05

Credit Risk - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Hospital has no investment policy that would further limit its investment choices.

Investment	Fair Value	Rating	Rating Organization
Sweep account	\$ 536,000	Not rated	Not rated
Commercial paper	2,500,000	A-I +	S&P

Concentration of Credit Risk - The Hospital places no limit on the amount they may invest in any one issuer. More than 5 percent of the Hospital's investments are in GE Capital commercial paper; these investments are 21.53 percent of the Hospital's investments.

Note 3 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below:

	2005	2004
Patient accounts receivable	\$ 27,974,927	\$ 26,836,950
Less:		
Allowance for uncollectible accounts	3,777,028	3,506,065
Allowance for contractual adjustments	19,041,531	20,384,751
Net patient accounts receivable	5,156,368	2,946,134
Other accounts receivable	570,636	531,833
Total accounts receivable	\$ 5,727,004	\$ 3,477,967

Alpena General Hospital

Notes to Financial Statements June 30, 2005 and 2004

Note 3 - Patient Accounts Receivable (Continued)

The Hospital grants credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. The composition of receivables from patients and third-party payors was as follows:

	2005 (%)	2004 (%)
Medicare	41	38
Blue Cross/Blue Shield of Michigan	17	18
Medicaid	10	17
Commercial insurance and other	12	10
Self-pay	20	17
Total	100	100

Note 4 - Patient Service Revenue

The Hospital grants equal access to health care services to all individuals regardless of financial status. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Net patient service revenue includes estimated retroactive adjustments under reimbursement agreements with third parties. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements occur.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable law and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors is as follows:

- Medicare - Inpatient acute-care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. All outpatient services are paid based on an established fee-for-service methodology subject to hold-harmless provisions.
- Blue Cross - Inpatient, acute-care services rendered to Blue Cross subscribers are also paid at prospectively determined rates per discharge. Outpatient services are reimbursed on a percentage of controlled charges.

Alpena General Hospital

Notes to Financial Statements June 30, 2005 and 2004

Note 4 - Patient Service Revenue (Continued)

- Medicaid - Inpatient, acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Capital costs relating to Medicaid patients are paid on a cost-reimbursement method. The Hospital is reimbursed for outpatient services on an established fee-for-service methodology.

Cost report settlements result from the adjustment of interim payments to final reimbursement under these programs and are subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying financial statements.

Net patient service revenue consisted of the following:

	2005	2004
Inpatient charges	\$ 73,488,093	\$ 63,796,327
Outpatient charges	109,855,576	96,759,689
Gross patient service charges	183,343,669	160,556,016
Less:		
Provisions for contractual allowances and adjustments	94,584,705	82,545,985
Provision for bad debts	2,441,000	2,044,000
Provision for charity care services provided	1,594,000	1,331,000
Net patient service revenue	\$ 84,723,964	\$ 74,635,031

Note 5 - Assets Limited as to Use

The composition of assets limited as to use at June 30, 2005 and 2004 is set forth in the following table. Investments are stated at fair value.

	2005	2004
Current assets - Designated by bond indenture for future bond payments - Cash and investments	\$ 818,741	\$ 783,693
Noncurrent assets:		
Designated by the board for future capital acquisitions - Cash and investments	\$ 9,994,243	\$ 9,960,606
Donor restricted:		
Specific purpose fund investments	502,633	447,970
Development fund investments	1,113,000	838,067
Development fund pledges	691,828	430,964
Total noncurrent assets	\$ 12,301,704	\$ 11,677,607

Alpena General Hospital

Notes to Financial Statements June 30, 2005 and 2004

Note 5 - Assets Limited as to Use (Continued)

Bond payment and reserve funds are restricted for interest and bond principal payments and future debt service.

Funds designated for replacement and improvement of property and equipment primarily consist of resources of the Hospital that the board has designated for specific purposes.

Donor restricted items are reflected as additions to the appropriate funds as follows:

Development Fund - The Hospital's development committee solicits gifts for certain specific projects. Amounts collected for these projects are included in the development fund, including pledges receivable, of which the majority is expected to be received within five years. The pledges are recorded net of an allowance for uncollectible pledges of \$254,000 and \$190,000 for 2005 and 2004, respectively.

Specific Purpose Funds - Amounts restricted for capital additions are transferred to the General Fund when expenditures that meet these requirements are made.

Alpena General Hospital

Notes to Financial Statements June 30, 2005 and 2004

Note 6 - Property and Equipment

Cost of capital assets and related depreciable lives for June 30, 2005 are summarized below:

	2004	Additions	Transfers	Retirements	2005	Depreciable Life - Years
Land and land improvements	\$ 2,332,485	\$ 19,445	\$ -	\$ -	\$ 2,351,930	5 - 25
Building	48,810,927	311,914	-	-	49,122,841	15 - 40
Equipment	28,957,203	2,537,185	700,000	(1,075,997)	31,118,391	3 - 20
Construction in progress	700,000	-	(700,000)	-	-	
Total	80,800,615	2,868,544	-	(1,075,997)	82,593,162	
Less accumulated depreciation:						
Land and land improvements	987,376	96,391	-	-	1,083,767	
Building	25,476,316	1,458,356	-	-	26,934,672	
Equipment	16,876,740	3,213,029	-	(1,015,142)	19,074,627	
Total	43,340,432	4,767,776	-	(1,015,142)	47,093,066	
Net carrying amount	<u>\$37,460,183</u>	<u>\$ (1,899,232)</u>	<u>\$ -</u>	<u>\$ (60,855)</u>	<u>\$35,500,096</u>	

Alpena General Hospital

Notes to Financial Statements June 30, 2005 and 2004

Note 6 - Property and Equipment (Continued)

Cost of capital assets and related depreciable lives for June 30, 2004 are summarized below:

	2003	Additions	Transfers	Retirements	2004	Depreciable Life - Years
Land and land improvements	\$ 2,317,340	\$ 15,145	\$ -	\$ -	\$ 2,332,485	5 - 25
Building	47,361,712	253,435	1,195,780	-	48,810,927	15 - 40
Equipment	27,294,840	4,385,949	-	(2,723,586)	28,957,203	3 - 20
Construction in progress	163,287	1,732,493	(1,195,780)	-	700,000	
Total	77,137,179	6,387,022	-	(2,723,586)	80,800,615	
Less accumulated depreciation:						
Land and land improvements	891,274	96,102	-	-	987,376	
Building	23,892,880	1,583,436	-	-	25,476,316	
Equipment	16,656,734	2,800,319	-	(2,580,313)	16,876,740	
Total	41,440,888	4,479,857	-	(2,580,313)	43,340,432	
Net carrying amount	\$ 35,696,291	\$ 1,907,165	\$ -	\$ (143,273)	\$ 37,460,183	

Alpena General Hospital

Notes to Financial Statements June 30, 2005 and 2004

Note 7 - Long-term Debt

Long-term liability activity for the year ended June 30, 2005 was as follows:

	2004	Current Year Additions	Current Year Reductions	2005	Amounts Due Within One Year
Bonds payable:					
Series 1999	\$ 6,500,000	\$ -	\$ (275,000)	\$ 6,225,000	\$ 225,000
Series 2000	5,225,000	-	(200,000)	5,025,000	300,000
Series 2003	3,195,000	-	(760,000)	2,435,000	785,000
Notes payable	1,128,035	728,383	(296,181)	1,560,237	354,155
Total long-term debt	<u>\$ 16,048,035</u>	<u>\$ 728,383</u>	<u>\$ (1,531,181)</u>	<u>\$ 15,245,237</u>	<u>\$ 1,664,155</u>

Long-term liability activity for the year ended June 30, 2004 was as follows:

	2003	Current Year Additions	Current Year Reductions	2004	Amounts Due Within One Year
Bonds payable:					
Series 1999	\$ 6,775,000	\$ -	\$ (275,000)	\$ 6,500,000	\$ 275,000
Series 2000	5,425,000	-	(200,000)	5,225,000	200,000
Series 2003	3,925,000	-	(730,000)	3,195,000	760,000
Note payable	-	1,128,035	-	1,128,035	189,222
Total long-term debt	<u>\$ 16,125,000</u>	<u>\$ 1,128,035</u>	<u>\$ (1,205,000)</u>	<u>\$ 16,048,035</u>	<u>\$ 1,424,222</u>

Alpena General Hospital

Notes to Financial Statements June 30, 2005 and 2004

Note 7 - Long-term Debt (Continued)

Long-term debt is summarized as follows:

- General Obligation Bonds Series 1999 bearing interest at rates ranging from 4.85 percent to 4.88 percent. Interest is due and payable on a semi-annual basis. The bonds are insured through a municipal bond insurance policy and are due in annual installments ranging from \$300,000 to \$550,000. The bonds are collateralized by net revenue of the Hospital.
- General Obligation Bonds Series 2000 bearing interest at rates ranging from 5 percent to 5.35 percent. Interest is due and payable on a semi-annual basis. The bonds are insured through a municipal bond insurance policy and are due in annual installments ranging from \$225,000 to \$550,000. The bonds are collateralized by net revenue of the Hospital.
- General Obligation Bonds Series 2003 bearing an interest rate of 3.53 percent. Interest is due and payable on a semi-annual basis. The bonds are insured through a municipal bond insurance policy and are due in annual installments ranging from \$785,000 to \$840,000. The bonds are collateralized by net revenue of the Hospital.
- Equipment notes payable that bear interest at fixed rates of 3.77 percent and 4.27 percent, are due in monthly installments of \$13,338 and \$20,912, respectively, including interest. The notes are collateralized by equipment.

In connection with the bond issues, the Hospital has agreed to various covenants. These covenants include maintaining a sinking fund for the annual principal payment and certain financial ratios.

The following is a schedule by years of bond principal and interest as of June 30, 2005:

Years Ending June 30	Long-term Debt	
	Principal	Interest
2006	\$ 1,664,155	\$ 694,540
2007	1,703,856	625,742
2008	1,799,169	554,159
2009	1,000,121	478,998
2010	677,936	438,329
2011-2015	3,650,000	1,675,384
2016-2020	4,750,000	636,175
Total payments	<u>\$ 15,245,237</u>	<u>\$ 5,103,327</u>

Alpena General Hospital

Notes to Financial Statements June 30, 2005 and 2004

Note 8 - Retirement Benefits

Plan Description - The Hospital sponsors both a defined benefit plan and a defined contribution plan. The Hospital participates in the Michigan Municipal Employees Retirement System (MMERS). MMERS covers all employees of the Hospital hired before March 1, 1999. The system provides retirement, disability, and death benefits to plan members and their beneficiaries. MMERS issues a publicly available financial report that includes financial statements and required supplementary information for the system. That report may be obtained by writing to the MMERS at 447 North Canal Road, Lansing, Michigan 48917.

Funding Policy - Benefit provisions of the MMERS and employer and employee obligations to contribute are outlined in Act No. 47 of the Public Acts of 1984, as amended. Pension expense consists of normal costs of the plan and amortization of prior service cost over a 40-year period, net of amortization of investment gains over a 10-year period. In previous years, the administrator of the MMERS plan reduced the Hospital's funding requirements due to favorable actuarial experience. This resulted in a timing difference between the pension expense recorded and the amount funded. This difference has been reflected as a long-term pension liability.

Annual Pension Cost - The Hospital's contributions to the plan amounted to \$2,303,008 and \$2,118,332 in 2005 and 2004, respectively. The actuarially determined contribution requirements have been met based on actuarial valuations performed at December 31, 2004 and 2003.

Three-year trend information is presented below to show the progress of the Hospital's status regarding certain key indicators:

	Year Ended December 31		
	2004	2003	2002
Annual Pension Cost (APC)	\$ 2,303,008	\$ 2,118,332	\$ 2,207,288
Percentage of APC contributed	100 %	100 %	100 %
Actuarial value of assets	\$ 90,048,730	\$ 85,876,316	\$ 79,395,244
Actuarial Accrued Liability (AAL) (entry age)	\$ 100,924,564	\$ 95,138,112	\$ 86,848,471
Unfunded Actuarial Accrued Liability (UAAL)	\$ (10,875,834)	\$ (9,261,796)	\$ (7,453,227)
Funded ratio (percent)	89.22 %	90.26 %	91.42 %
Covered payroll	\$ 25,082,922	\$ 24,144,823	\$ 27,240,977
UAAL as percentage of covered payroll	43.36 %	38.36 %	27.36 %

Alpena General Hospital

Notes to Financial Statements June 30, 2005 and 2004

Note 8 - Retirement Benefits (Continued)

The Hospital sponsors a defined contribution plan covering all employees hired after March 1, 1999. Participating employees in this plan may contribute a percentage of their gross earnings and the Hospital contributes 3 percent to 9 percent based on participants' contributions and hire date. The Hospital's contribution totaled \$920,626 and \$499,202 for the years ended June 30, 2005 and 2004, respectively.

Note 9 - Deferred Revenue

Deferred revenue relates to a prepaid lease from a joint venture that occupies a portion of a building attached to the Hospital. Under terms of the agreement, the lessee paid for a portion of the construction cost of the building, which the Hospital owns. In exchange, the Hospital issued a 30-year lease. Under terms of the lease agreement, the lessee makes no payments for rental of the building although payments are made to the Hospital for certain operating cost of the building, such as housekeeping, utilities, and maintenance.

During the year ended June 30, 2001, the Hospital recorded deferred revenue and building in the amount of \$1,860,982. Rental income of \$62,400 will be recognized each year for the remainder of the 30-year lease.

	2005	2004
Deferred revenue - Beginning of year	\$ 1,668,582	\$ 1,730,982
Less rental income recognized	<u>(62,400)</u>	<u>(62,400)</u>
Deferred revenue - End of year	<u>\$ 1,606,182</u>	<u>\$ 1,668,582</u>

Note 10 - Risk Management

The Hospital is exposed to various risks of loss related to property loss, torts, errors, omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The Hospital has purchased commercial insurance for property loss, torts, errors, and omissions and participates in the Michigan Hospital Association risk pool for claims related to employee injuries (workers' compensation) and unemployment. The Hospital is self-insured for medical benefits provided to employees. The Hospital has purchased a stop-loss insurance policy to cover individual medical claims in excess of amounts ranging from \$75,000 to \$100,000 in any one plan year. Settled claims relating to commercial insurance have not exceeded the amount of insurance in any of the past three fiscal years.

The Michigan Hospital Association Risk Pool program operates as a common risk-sharing management program for hospitals in Michigan; member premiums are used to purchase excess insurance coverage and to pay member claims in excess of deductible amounts.

Alpena General Hospital

Notes to Financial Statements June 30, 2005 and 2004

Note 10 - Risk Management (Continued)

Medical - The Hospital estimates the liability for medical claims that have been incurred through the end of the fiscal year, including both claims that have been reported, as well as those that have not yet been reported. These estimates are recorded as a short-term liability.

Changes in the estimated liability for the past two years were as follows:

	2005	2004
Estimated liability - Beginning of year	\$ 435,064	\$ 593,555
Estimated claims incurred, including changes in estimates	3,020,000	2,881,349
Claim payments	(2,936,790)	(3,039,840)
Estimated liability - End of year	<u>\$ 518,274</u>	<u>\$ 435,064</u>

Malpractice - The Hospital is insured against potential professional liability claims under a claims-made policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital must pay a deductible toward the cost of litigating or settling any asserted claims. In addition, the Hospital bears the risk of the ultimate costs of any individual claim exceeding the policy limits for claims asserted in the policy year.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during the claims-made term, but reported subsequently, will be uninsured.

The Hospital is involved in certain legal actions arising from services provided to patients. Although the Hospital is unable to precisely estimate the ultimate cost of settlements of professional liability claims, provision is made for management's best estimate of losses of uninsured portions of pending claims and for known incidents that may result in the assertion of additional claims.

The accrual for estimated malpractice claims was \$677,000 for both June 30, 2005 and 2004. Management believes, after considering legal counsel's evaluations of all actions and claims, that insurance coverage and accruals for estimated losses are adequate to cover expected settlements.

Alpena General Hospital

Notes to Financial Statements June 30, 2005 and 2004

Note 11 - Assets Held by Others

The Northeast Michigan Community Foundation has an endowment fund established by donors for the benefit of the Hospital. The donors have stipulated that the principal is to be maintained in perpetuity and the Hospital is entitled to the earnings on such funds for operating purposes. The balance of the fund held at the Northeast Michigan Community Foundation at June 30, 2005 and 2004 was \$1,427,365 and \$1,265,661, respectively. These funds are not included with the Hospital's assets on the statement of net assets.

Additional Information

Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial
Statements Performed in Accordance with *Government Auditing Standards*

To the Board of Trustees
Alpena General Hospital

We have audited the financial statements of Alpena General Hospital as of and for the year ended June 30, 2005 and have issued our report thereon dated September 8, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered Alpena General Hospital's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Alpena General Hospital's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to the management of Alpena General Hospital in a separate letter dated October 17, 2005.

To the Board of Trustees
Alpena General Hospital

This report is intended solely for the information and use of the board of trustees, management, and federal awarding agencies and is not intended to be, and should not be, used by anyone other than these specified parties.

Plante & Moran, PLLC

September 8, 2005



Plante & Moran, PLLC
1010 S. Garfield Ave.
Traverse City, MI 49686
Tel: 231.947.7800
Fax: 231.947.0348
plantemoran.com

October 17, 2005

Board of Trustees
Alpena General Hospital

In planning and performing our audit of the financial statements of Alpena General Hospital for the year ended June 30, 2005, we considered the Hospital's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. The consideration we gave to the internal control structure was not sufficient for us to provide any form of assurance on it. However, we noted certain matters involving the internal control structure and its operation where we feel opportunities for improvement exist, as well as some additional areas for Board consideration.

This report contains our observations, comments, and other items we feel warrant your consideration. All items are presented for your consideration on attachments as outlined below:

TITLE	EXHIBIT
GASB Update	A
Highlights of the OIG's 2005 Work Plan	B
Corporate Compliance Update	C
Developing a HIPAA Contingency Plan	D

The report is intended solely for the information and use of the Board of Trustees, management, and others within the Hospital. Please call us if we can help on implementing any of the above recommendations.

Sincerely,

PLANTE & MORAN, PLLC

Michael A. Baker, CPA
Partner



A worldwide association of independent accounting firms

Alpena General Hospital
Exhibit A
GASB Update

The Government Accounting Standards Board (GASB) has recently released the following new pronouncements that will have a direct impact on the financial statements of the Hospital:

- GASB Statement No. 40 - *Deposit and Investment Risk Disclosures*
- GASB Statement No. 45 - *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*

GASB Statement No. 40 is applicable for the year ended June 30, 2005 and will require additional disclosures in the financial statements regarding risks related to deposits and investments held by the Hospital. These risks include credit risk, concentration of credit risk, interest rate risk, and foreign currency risk.

GASB Statement No. 45 provides guidance for local units of government in recognizing the cost of retiree healthcare, as well as any "other" postemployment benefits (other than pensions). The intent of the new rules is to recognize the cost of providing retiree healthcare coverage over the working life of the employee, rather than at the time the healthcare premiums are paid.

The new pronouncement will require a valuation of the obligation to provide retiree healthcare benefits, including an amortization of the past service cost over a period of up to 30 years. The valuation must include an annual recommended contribution (ARC). While the ARC does not need to be funded each year, any under funding must be reported as a liability on the statement of net assets.

This valuation will need to be performed by an actuary if the total participants exceed 100. Participants are defined as employees in active service, terminated employees not yet receiving benefits, plus retirees and beneficiaries currently receiving benefits. For plans with 100 to 200 participants, the actuarial valuation must be at least every three years; for those over 200 participants, at least every other year.

This statement will be effective for the year ended June 30, 2007. The planning to make the ARC generally requires from three to six months for an actuarial valuation, plus six months lead time to work the numbers into the budget. Therefore, we recommend that you begin the actuarial valuation at least one year prior to the above date.

Alpena General Hospital
Exhibit B
Highlights of the OIG's 2005 Work Plan

The 2005 Work Plan issued by the Office of the Inspector General (OIG) identifies projects that have evolved in response to new issues and the shifting priorities of Congress. The OIG spends significant resources in the investigation of fraud and misconduct committed against the Medicare and Medicaid programs.

Highlights from the OIG's 2005 Work Plan include, but are not limited to:

Rebates Paid to Hospitals – OIG will determine whether hospitals are properly identifying purchase credits as a separate line item in their Medicare cost reports. This will be done through visiting several large vendors and determining the amount of rebates paid to hospitals in a given year, and then examining a sample of cost reports to determine if the rebates were properly credited.

Outpatient Cardiac Rehab Services – OIG will determine whether cardiac rehab services provided by hospital outpatient departments meet Medicare coverage requirements. Medicare covers such rehab under the "incident-to" a physician's professional services benefit, which requires that the services of non-physician personnel be furnished under the physician's direct supervision.

Lifetime Reserve Days – OIG will determine how hospitals comply with the current requirement to notify Medicare beneficiaries about the use of lifetime reserve days and also assess the appropriateness and feasibility of providing an additional notification prior to a beneficiary's exhaustion of them. Medicare beneficiaries are entitled to an unlimited number of 90-day episodes of care. They may also extend their inpatient benefit by up to a lifetime total of 60 days. These are called lifetime reserve days; they are not renewable.

Physicians - Coding of Evaluation and Management (E&M) Services – OIG will examine patterns of physician coding of E&M services and determine whether these services were coded accurately. In 2003, Medicare allowed over \$29 billion for E&M services. In prior work, the OIG has found that a significant portion of certain categories of these services were billed with incorrect codes resulting in large overpayments.

Physicians - Use of Modifier 25 – In general, a provider should not bill E&M codes on the same day as a procedure or other service unless the E&M service is a significant, separately identifiable service from such procedure or service. OIG will determine whether providers use modifier 25 appropriately.

Alpena General Hospital
Exhibit C
Corporate Compliance Update

The Office of the Inspector General (OIG) recently issued its Supplemental Compliance Program Guidance for Hospitals (CPG). The full text of this notice is contained in Federal Register Notice 70 FR 4858 dated January 31, 2005. Through this notice, the OIG is supplementing its prior compliance program guidance for hospitals issued in 1998. The supplemental CPG contains new compliance recommendations and an expanded discussion of risk areas, taking into account recent changes to hospital payment systems and regulations, evolving industry practices, current enforcement priorities, and lessons learned in the area of corporate compliance. The supplemental CPG provides voluntary guidelines to assist hospitals and hospital systems in identifying significant risk areas and in evaluating and, as necessary, refining ongoing compliance efforts.

Realizing the diversity of the hospital industry, the OIG's CPG does not provide a "one-size-fits-all" guidance, but rather encourages hospitals to identify and focus their compliance plans and efforts on areas of potential concern and risk that are the most relevant to their individual organizations and to the delivery of healthcare in general.

The OIG explained that hospitals may gain important information by voluntarily implementing a compliance program that includes:

1. A demonstration of the hospital's commitment to honest and responsible corporate conduct.
2. A plan of increasing the likelihood of preventing, identifying and correcting unlawful and unethical behavior at an early stage.
3. A method of encouraging employees to report potential problems to allow for appropriate internal inquiry and corrective action.
4. A plan that, through early detection and reporting, minimizes any financial loss to government and taxpayers, as well as any corresponding financial loss to the hospital.

The supplemental CPG also indicates several areas that the OIG considers ripe for fraudulent activity. Outpatient bill coding, due to its complexity with both prospective payment system codes and ambulatory payment classification codes, especially concerns the OIG. Improper coding and billing for "same-day" discharges and readmissions, and improper claims for pass-through drugs, outlier payments, and provider-based services are also new problem areas.

We commend the Hospital on its efforts to support and monitor corporate compliance activities. We do, however, strongly encourage the Hospital to thoroughly review the new supplemental CPG and incorporate it into the existing plan and activities.

Alpena General Hospital
Exhibit D
Developing a HIPAA Contingency Plan

Computer systems are never 100 percent reliable. They can crash, making data difficult, if not impossible, to recover. Under the HIPAA Security Rule healthcare organizations must develop a data backup plan. Covered entities should have started complying with the Security Rule in April of this year. Healthcare organizations must establish and implement procedures to create and maintain retrievable exact copies of electronic protected health information (PHI) and backup data on a regular basis. Electronic PHI should not be interpreted as being just electronic medical records, but also includes all patient information maintained on a computerized system, including scheduling, medications, lab results, etc. Organizations must also establish, and implement as needed, procedures to restore any lost data in the case of any disaster.

HIPAA also requires covered entities to implement an emergency mode operation plan containing procedures that enable them to continue critical business processes that protect the security of electronic PHI. This may be as simple as maintaining paper records until the emergency situation is over. Contingency plans need to be tested and revised regularly. Initially, testing should be done in sections or functional areas and during nonoperating hours.

Covered entities also need to review and document the relative importance of all hardware and software applications. For example, if a covered entity uses two applications, one for scheduling and one for accessing certain electronic PHI, it should consider which one is more critical or important to restore first in the event of an emergency. The order of priority will be very important in creating the detailed backup, disaster recovery, and emergency mode operations.

Establishing procedures that allow support personnel to get into the facility and restore lost data in the event of an emergency is also crucial. This will help ensure those needing access in an emergency have access, including any individuals who normally do not have access to the covered entity's electronic information.

The primary objectives of a disaster recovery plan are to protect the organization in the event that all or part of its operations and/or computer services are rendered unusable, minimize disruption of operations, and ensure some level of organizational stability and orderly recovery after a disaster. Moreover, a disaster recovery plan provides a sense of security, minimizes the risk of delays, guarantees the reliability of standby and secondary systems and processes, establishes a standard plan for testing, and minimizes decision making during a disaster.

We recommend that the Hospital review any contingency plans currently in place and ensure that the HIPAA requirements are covered.